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INDIRECT ENCROACHMENT ON FEDERAL AUTHORITY BY THE TAXING POWERS OF THE STATES.[1] VII

II. Regulations of Interstate Commerce (*concluded*)

2. *Taxes not Discriminating Against Interstate Commerce* (concluded)

C. Taxes on Acts, Occupations or Income (*concluded*)

II. *Taxes on Net Income "As Such"*

IT has already been disclosed that at the October, 1917, Term the Supreme Court in *United States Glue Co.* v. *Oak Creek*[2] sanctioned the inclusion of income from interstate commerce in a general state income tax measured by net income from all sources. The difference "between a tax measured by gross receipts and one measured by net income" was said to afford "a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental."[3]

The United States Glue Company was a domestic corporation; and in propounding and answering the question to be decided, Mr. Justice Pitney included that fact. After summarizing the provisions of the statute and their application to the plaintiff, he said:

"Stated concisely, the question is whether a State, in levying a general income tax upon the gains and profits of a domestic corporation, may include in the computation the net income derived from transactions in interstate commerce without contravening the commerce clause of the Constitution of the United States."[4]

And the answer is stated as follows:

"And so we hold that the Wisconsin income tax law, as applied to the plaintiff in the case before us, cannot be deemed to be so direct a

[1] For preceding instalments of this discussion see 31 HARV. L. REV. 321–72 (January, 1918); *Ibid.*, 572–618 (February, 1918); *Ibid.*, 721–78 (March, 1918); *Ibid.*, 932–53 (May, 1918); 32 HARV. L. REV. 234–65 (January, 1919); and *Ibid.*, 374–416 (February, 1919).

[2] 247 U. S. 321, 38 Sup. Ct. Rep. 499 (1918).

[3] 247 U. S. 321, 328, 38 Sup. Ct. Rep. 499 (1918).

[4] *Ibid.*, 326.

burden upon plaintiff's interstate business as to amount to an unconstitutional interference with or regulation of commerce among the States. It was measured not by the gross receipts, but by the net proceeds from this part of plaintiff's business, along with a like imposition upon its income derived from other sources, and in the same way that other corporations doing business within the State are taxed upon that proportion of their income derived from business transacted and property located within the State, whatever the nature of their business." [5]

These portions of the opinion, taken alone, would confine the decision to the point that a domestic corporation, engaged in both local and interstate commerce, cannot exclude interstate income from a tax on net income from all kinds of business which is imposed equally on other corporations doing business in the state. This was as far as the court had to go to dispose of the controversy before it. It was not called upon to say whether the result would have been the same in the case of an individual, a partnership or a foreign corporation or of a business that was exclusively interstate. It might, however, have narrowed its decision still further, as we shall see later.[6]

While the decision involved a domestic corporation and the court confined the case to such a corporation, there is no intimation in the opinion that an individual or partnership or foreign corporation would have occupied a more favorable position. Indeed, there are hints to the contrary. It is thought important to mention that the plaintiff was taxed "in the same way that other corporations doing business within the State are taxed, . . . whatever the nature of their business." [7] The incidence of a similar burden on other corporations is one of the reasons why this corporation cannot complain. The reasonable inference is that the court, in seeming in part of the opinion to confine the decision to the kind

[5] 247 U. S. 321, 328, 38 Sup. Ct. Rep. 329 (1918).

[6] *Infra*, page 643–45.

[7] 247 U. S. 321, 329, 38 Sup. Ct. Rep. 499 (1918). This statement as to other corporations is not literally true, for, as we have seen from Northwestern Life Insurance Co. *v.* Wisconsin, 247 U. S. 132, 38 Sup. Ct. Rep. 444 (1918), 32 HARV. L. REV. 408 *ff.*, a gross receipts tax was levied on insurance companies in lieu of all other taxes except those on real estate. Public utilities are also excluded from the provisions of the income tax law and subjected to *ad valorem* assessment (note 34, *infra*). These exceptions, however, do not appear important, since the other methods of assessment are regarded as imposing burdens substantially equivalent to those which would result from subjection to the income tax.

of corporation that was before it, does not mean to suggest any such distinction between foreign and domestic corporations as appears to be made in dealing with excises measured by total capital stock.[8] And that the opinion is not confined to corporations is apparent from another paragraph in which reference is made to "persons." After distinguishing a tax on gross receipts from one on net income, Mr. Justice Pitney says of the latter:

"Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States." [9]

The qualifying phrase "otherwise subject to the jurisdiction of the state" opens the door to the inquiry whether a foreign corporation engaged exclusively in interstate commerce could be taxed on its net income earned within the state. Such corporations are "subject to the jurisdiction of the state" from the standpoint of service of judicial process,[10] and taxation of property.[11] But they

[8] Compare Looney *v.* Crane Co., 245 U. S. 178, 38 Sup. Ct. Rep. 85 (1917), 31 HARV. L. REV. 600–18, with Kansas City, M. & B. R. R. Co. *v.* Stiles, 242 U. S. 111, 37 Sup. Ct. Rep. 58 (1916), 31 HARV. L. REV. 599–600. See also 33 POLITICAL SCIENCE QUARTERLY, 557, note 1.

[9] 247 U. S. 321, 329, 38 Sup. Ct. Rep. 499 (1918).

[10] International Harvester Co. *v.* Kentucky, 234 U. S. 579, 34 Sup. Ct. Rep. 944 (1914).

[11] This does not appear to have been established by explicit decision, but the many cases holding that foreign corporations engaged partly in interstate commerce are not entitled to exemption from property taxation convey no hint that the result would be different if the business in which the property was employed was exclusively interstate. In St. Louis *v.* Wiggins Ferry Co., 11 Wall. (78 U. S.) 423 (1871), the only reason given for holding that the property of a foreign corporation engaged exclusively in interstate commerce was not taxable in St. Louis was that the property had no taxable situs there. In Henderson Bridge Co. *v.* Kentucky, 166 U. S. 150, 17 Sup. Ct. Rep. 532 (1897), in which Kentucky was allowed to tax the Kentucky part of an interstate bridge owned by a Kentucky corporation, it appeared from the statement of facts that Illinois had assessed that part of the bridge which lay within its borders. In Gloucester Ferry Co. *v.* Pennsylvania, 114 U. S. 196, 206, 5 Sup. Ct. Rep. 826 (1885), Mr. Justice Field declared: "It is true that the property of corporations engaged in foreign or interstate commerce, as well as the property of corporations

are not subject to the jurisdiction so as to be liable to a privilege tax on the conduct of their business,[12] or to certain police requirements set forth as a condition on bringing suit in the state courts.[13] Are they so subject to the jurisdiction as to be liable to a tax on their net income? Mr. Justice Pitney plainly intimates that they are. A tax on net income, he says, is "like a tax upon property, or upon franchises treated as property." It is "but a method of distributing the cost of government"; it "constitutes one of the ordinary and general burdens of government." If the property of those engaged exclusively in interstate commerce is not exempt from state taxation, there is no reason to accord them immunity from a tax on their net income, which is "but a method of distributing the cost of government, like a tax upon property." The important thing in the mind of the court seems to be the generality of the burden, with the consequent impossibility of discrimination against interstate commerce.

The result of this venture at mind-reading coincides with the analysis previously given of state taxes on property assessed by capitalizing the income earned from its use. To repeat Mr. Carter's concession in his brief for the companies in the Ohio Express cases:

"Inasmuch as the existence of the States is necessary to the existence of interstate commerce, that ordinary system of taxation which is

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engaged in other business, is subject to State taxation, provided always it be within the jurisdiction of the State." As the case before the court involved a foreign corporation engaged exclusively in interstate commerce, it is fair to presume that the *dictum* above quoted was uttered with such a corporation in mind. In Old Dominion Steamship Co. *v.* Virginia, 198 U. S. 299, 25 Sup. Ct. Rep. 686 (1905), the inference from the statement of facts is that the tug "Germania," which was one of the vessels of a foreign corporation held taxable in Virginia, was engaged exclusively in interstate commerce, though this fact is not mentioned in the opinion. Property owned by a foreign corporation and employed exclusively in work for the United States government is taxable. Gromer *v.* Standard Dredging Co., 224 U. S. 362, 32 Sup. Ct. Rep. 499 (1912). The conclusion is irresistible that the many declarations that property is not exempt from state taxation because it is employed in interstate commerce are intended to apply to property of foreign corporations engaged exclusively in that commerce.

[12] Cheney Brothers Co. *v.* Massachusetts, 246 U. S. 147, 38 Sup. Ct. Rep. 295 (1918); York Manufacturing Co. *v.* Colley, 247 U. S. 21, 38 Sup. Ct. Rep. 430 (1918).

[13] International Text Book Co. *v.* Pigg, 217 U. S. 91, 30 Sup. Ct. Rep. 481 (1910); International Text Book Co. *v.* Lynch, 218 U. S. 664, 31 Sup. Ct. Rep. 225 (1910); Buck Stove Co. *v.* Vickers, 226 U. S. 205, 33 Sup. Ct. Rep. 41 (1912); Sioux Remedy Co. *v.* Cope, 235 U. S. 197, 35 Sup. Ct. Rep. 57 (1914).

necessary to the existence of the States, namely, taxation upon all property within them, must be permitted, and the property employed in interstate commerce is not to be exempted. . . . Were it not subject to taxation in this form the effect would be to confer upon it an affirmative advantage equivalent to a pecuniary bounty equal to the amount of the tax from which it is exempted." [14]

With the advent of general state-wide income taxes, the "ordinary system of taxation which is necessary to the existence of the states" is no longer confined to property taxation. The income tax has come to constitute one of the "ordinary and general" burdens of government. Reason and psychology combine to warrant the expectation that the Supreme Court will not exclude foreign corporations engaged exclusively in interstate commerce from the "corporations otherwise subject to the jurisdiction of the states" with respect to taxes on net incomes.[15]

It seems safe, therefore, to state the principle of the Oak Creek case by saying that a general state-wide tax on net income is not "an unconstitutional interference with or regulation of commerce among the states" by reason of the inclusion of net income from

[14] This passage is quoted more at length in 32 HARV. L. REV. 261.

[15] This position is taken by the supreme court of Wisconsin in Superior *v.* Allouez Bay Dock Co., 166 Wis. 76, 80, 164 N. W. 362 (1917), in which Chief Justice Winslow says:

"It must be admitted that the defendant's income arose entirely from interstate commerce business. . . . Is the levying of an income tax measured by the income so derived a burden upon interstate commerce?

"The question is not free from difficulty, but we think it must be answered in the negative. Income taxation is not taxation of property, but is more nearly akin to taxes levied upon privileges or occupations. Its amount may be measured by the receipts of the business, but it is not in any true sense a tax upon the business itself. The subject is covered, as it seems to us, by the decisions of this court in *United States Glue Co.* v. *Oak Creek*, 161 Wis. 211, 153 N. W. 241, and *Northwestern Mut. L. Ins. Co.* v. *State*, 163 Wis. 484, 155 N. W. 609, 158 N. W. 328, and the cases therein cited."

The cases relied on do not involve concerns whose business was exclusively interstate, so the declaration in the Superior case is no more than the assertion that this does not seem material to the court. Moreover, the decision in the Superior case that those engaged exclusively in interstate commerce may be constitutionally subjected to a tax on their net income was a declaration on a moot point, because the case held that the defendant was exempted from income taxation, for the reason that the property from which the income was derived was railroad property, and the complainant was therefore entitled to the benefit of the provision in the Income Tax Law which exempts "incomes derived from property and privileges by persons now required by law to pay taxes or license fees directly into the treasury of the state in lieu of taxes" (166 Wis. 76, 81).

interstate commerce. The court emphasizes the point that, in the absence of discrimination, the effect of such a tax on interstate commerce is "indirect" and therefore constitutionally innocuous. It regards this effect as identical with the effect on exports of the federal net income tax on income from an exporting business. Two weeks earlier in *Peck & Co.* v. *Lowe* [16] the court had held that it was not a tax on exports to tax the net income of an exporting business. In the opinion Mr. Justice Van Devanter had said:

"The tax in question is unlike any of those heretofore condemned. It is not laid on articles in course of exportation, or on anything which inherently or by the usages of commerce is embraced in exportation or any of its processes. On the contrary, it is an income tax laid generally on net incomes. . . . It is both nominally and actually a general tax. . . . There is no discrimination. At most, exportation is affected only indirectly and remotely. The tax is levied after exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses. Thus what is taxed — the net income — is as far removed from the exportation as are articles intended for export before the exportation begins." [17]

This passage was paraphrased by Mr. Justice Pitney in the Oak Creek case, prefatory to pointing out the distinction between the measures of gross and of net income and to minimizing the deterrent effect on interstate commerce of the latter, since a tax on net profits "does not arise at all unless a gain is shown over and above expenses and losses, and the tax cannot be heavy unless the profits are large." [18]

We may take it for granted, then, that the legal character of the recipient and the nature of the business in which the recipient is engaged are immaterial elements in considering the constitutionality of a state-wide, all-inclusive general tax on net income from business done within the state. The recipient may be an individual, a partnership, a domestic or a foreign corporation. The business may be exclusively interstate. But the tax must be general, and the measure must probably be net, and not gross, income, with the possible qualification that some latitude will be allowed the states in prescribing what are permissible deductions by way

[16] 247 U. S. 165, 38 Sup. Ct. Rep. 432 (1918).
[17] 247 U. S. 165, 174–75, 38 Sup. Ct. Rep. 432 (1918).
[18] 247 U. S. 321, 329, 38 Sup. Ct. Rep. 499 (1918).

of interest on indebtedness, expenses, etc., in assessing the taxable net income. The statement that the legal character of the recipient and the source of the income are not significant is not meant to preclude further inquiry into the taxability of income from extra-state business or from interest or other compensation paid by the national government. In determining the constitutionality of state taxation of such income, the legal status of the recipient is likely to be of controlling importance.[19]

It is doubtless a wholly moot question whether a general state tax on gross income would pass muster with the Supreme Court. No such tax is likely to be levied. It would bear most unequally on different individuals and different enterprises. This consideration will probably always receive more weight from legislators than that which will be given to the opposing element that in some instances volume of transactions bears a closer relation to the cost of governmental supervision than does the balance at the end of the fiscal year. Such exceptional instances may be taken care of by gross-income taxes in lieu of other taxes. If, however, a state should seek to impose a general tax on gross income, it will have to reckon with Mr. Justice Pitney's opinion in the Oak Creek case, which plainly discountenances the inclusion of receipts from interstate commerce in such a tax. No actual decision, however, precludes such inclusion. All of the gross income taxes that have been declared unconstitutional have been levies on selected enterprises. So far as words go, a general tax on gross income can be called "but a method of distributing the cost of government," as readily as can a general tax on net income. And there is an indication in Mr. Justice Bradley's opinion in *Philadelphia & Southern Mail S. S. Co.* v. *Pennsylvania* [20] that in 1887 the Supreme Court was inclined to think that a general state income tax could levy on receipts from interstate commerce, even though the measure of the tax was gross, rather than net, income.

This opinion is referred to by Mr. Justice Pitney in the Oak Creek case, in which he quotes Mr. Justice Bradley as saying:

"The corporate franchises, the property, the business, the income of corporations created by a state may undoubtedly be taxed by the state; but in imposing such taxes care should be taken not to interfere

[19] See *infra*, pages 649 *ff.*

[20] 122 U. S. 326, 7 Sup. Ct. Rep. 1118 (1887).

with or hamper, directly or by indirection, interstate or foreign commerce, or any other matter exclusively within the jurisdiction of the Federal government." [21]

Previously Mr. Justice Pitney says that the subject of consideration in the Philadelphia case was "the distinction between direct and indirect burdens, with particular reference to a comparison between a tax upon the gross returns of carriers in interstate commerce and a general income tax imposed upon all inhabitants incidentally affecting carriers engaged in such commerce. . . ." [22] From this Mr. Justice Pitney proceeds to point out "the correct line of distinction," as illustrated in *Crew Levick Co.* v. *Pennsylvania* [23] and *Peck & Co.* v. *Lowe*.[24]

Between these two cases there was a double distinction. One involved a tax on gross receipts imposed on selected enterprises; the other, a tax on net income imposed generally on all enterprises and individuals. When Mr. Justice Bradley made "particular reference to a comparison between a tax upon the gross returns of carriers engaged in interstate commerce and a general income tax imposed on all inhabitants," [25] he appears to have had in mind only the distinction between generality and partiality. There is no indication that he thought it material whether a general income tax was on gross, or on net, income. The pertinent paragraph of his opinion is the one immediately preceding that from which Mr. Justice Pitney quotes. After saying that "there is another point, however, which may properly deserve some consideration," Mr. Justice Bradley continues:

"Can the tax in this case be regarded as an income tax? And, if it can, does that make any difference as to its constitutionality? We do not think that it can properly be regarded as an income tax. It is not a general tax on the incomes of all the inhabitants of the state, but a special tax on transportation companies. Conceding, however, that an income tax may be imposed on certain classes in the community, distinguished by the character of their occupations, this is not an income tax on the class to which it refers, but a tax on their receipts for trans-

[21] 122 U. S. 326, 345, 7 Sup. Ct. Rep. 1118 (1887); quoted in 247 U. S. 321, 327, 38 Sup. Ct. Rep. 499 (1918).

[22] 247 U. S. 321, 327, 38 Sup. Ct. Rep. 499 (1918).

[23] 245 U. S. 292, 38 Sup. Ct. Rep. 126 (1917), 32 HARV. L. REV. 409 ff.

[24] Note 16, *supra*.

[25] Note 23, *supra*.

portation only. Many of the companies included in it may, and undoubtedly do, have incomes from other sources, such as rents of houses, wharves, stores, and water power, and interest on moneyed investments. . . . It is unnecessary, therefore, to discuss the question which would arise if the tax were properly a tax on income. It is clearly not such, but a tax on transportation only." [26]

Here obviously Mr. Justice Bradley regards generality as the only essential of a tax "properly a tax on income." He lays no foundation for the distinction between gross and net income relied on by Mr. Justice Pitney in sustaining the Wisconsin income tax. Nor was it necessary to draw such a distinction in the Oak Creek case, since the generality of the tax there involved would have differentiated it from all taxes previously declared invalid. Had the court been inclined to narrow its decision as much as possible, the opinion might easily have declared that, since the Wisconsin tax was both general and measured by net income, there was no bar against its application to income from interstate commerce, thereby explicitly leaving open for future determination the question whether either of these qualifications in the absence of the other would entitle the law to the same approval. But, in so far as the opinion rather than the decision is to be looked at as expressing the law for which the case stands, it seems necessary to conclude that a general income tax on gross receipts cannot take toll from interstate commerce.

Such gross receipts from interstate as well as local commerce may, as we have seen,[27] be the measure of a tax in lieu of a property tax, provided the burden thereby imposed is not substantially heavier than what would be laid by the ordinary property tax. If this is true of gross-receipts taxes on selected corporations or enterprises, it must also be true of a general tax on gross receipts in lieu of a property tax. But such a tax is not likely to be adopted east or west of Russia. One may with safety follow Henry George far enough to disapprove of relieving real estate from *ad valorem* taxes in order to take only a percentage of the realized gross returns. And though we may anticipate that, in many states, income taxes will soon be substituted for other demands on chattels as well as on intangibles, it is inconceivable that such income taxes will be

[26] 122 U. S. 326, 344–45, 7 Sup. Ct. Rep. 1118 (1887).
[27] 32 HARV. L. REV. 377–416.

guilty of the inequalities of burden that would ensue from allowing to no one any deduction from gross receipts.

This brings us to the element in the Wisconsin income tax that the Supreme Court did not mention. Nothing was said in the opinion in the Oak Creek case about the extent to which the tax was in lieu of other demands. There is no hint that a state has to exempt property of any kind in order to include receipts from interstate commerce in a general tax on net incomes. Yet the Supreme Court was undoubtedly aware of the fact that the Wisconsin tax was one substantially in lieu of all other taxes on chattels and intangibles. In *Northwestern Mutual Life Insurance Co.* v. *Wisconsin* [28] the opinion of Mr. Justice Day quoted a statement from the Wisconsin supreme court to the effect that the Income Tax Law "marked the abandonment of the attempt to levy personal property taxes upon" securities and credits.[29] Whether it was called to the attention of the Supreme Court that Wisconsin also allowed taxes on chattels to be deducted from the assessment of the income tax does not appear; but such was the case,[30] and the Supreme Court would hardly have neglected to inquire about it had it been regarded as important. The general nature of the Wisconsin tax was thus summarized by Chief Justice Winslow of the Wisconsin supreme court in an opinion rendered in 1912:

"By the present law it is quite clear that personal property taxation is for all practical purposes becoming a thing of the past. The specific exemptions of all money and credits and the great bulk of stocks and bonds, as well as of all farm machinery, tools, wearing apparel, and household furniture in actual use, regardless of value, goes far to eliminate taxation of personal property; while the provision that he who pays personal property taxes may have the amount so paid credited on his income tax for the year seems to put an end to any effective taxation of personal property. That taxation of such property has proven a practical failure will be admitted by all who have given any attention to the subject. Doubtless this was one of the main arguments in the legislative mind for the passage of the present act. By this act the legislature has, in substance, declared that the state's system of taxation shall be changed from a system of uniform taxation of property (which so far as personal property is concerned has proven a failure) to

[28] 247 U. S. 132, 38 Sup. Ct. Rep. 444 (1918).

[29] 247 U. S. 132, 136, 38 Sup. Ct. Rep. 444 (1918).

[30] WISCONSIN STAT. (1915), chap. 48 *a*, § 1087 *m*–26.

a system which shall be a combination of two ideas, namely, taxation of persons progressively, according to ability to pay, and taxation of real property uniformly, according to value." [31]

Thus the Wisconsin tax was substantially one in lieu of all other taxes except those on real estate. Unlike the gross-receipts tax on insurance companies sustained in *Northwestern Mutual Life Insurance Co.* v. *Wisconsin*,[32] the net-income tax included the income from real estate,[33] so that the economic interest in land was taxed twice. Such a double burden might conceivably have raised a question under the commerce clause in the case of railroads had they been subject to the income tax. If the assessment of their real estate took account of the value contributed by the use to which it was put, and the value of that use was again tapped by an income tax, there would be some basis for a contention that the state had created a tax system whereby interstate carriers were taxed more heavily than many kinds of local business. In Wisconsin, however, railroads are not subject to the income tax, but are assessed by the *ad valorem* method which in practice gets at the "intangible" value contributed by the income.[34] And chattels and intangibles pay but one tax. The Supreme Court, however, did not mention this element in the situation before it. It would seem, then, that it means to allow a general state tax on net incomes to take toll from interstate commerce, even though the tax is in addition to familiar and customary levies on chattels and choses in action. This, however, is the inference from silence and neglect, and not from anything vocal. Explicit consideration may move the court to a different conclusion.

If we may assume that a state is determined that state and local governments are to get a definite amount of revenue, the question whether a general income tax is in lieu of other demands does not seem of great importance. Such an income tax is *pro tanto* in lieu of other demands, whether specific property is exempted or not, since it necessarily reduces the assessment or the rate of levy on other sources of revenue. Our assumption that some predeter-

[31] Income Tax Cases, 148 Wis. 456, 505–06, 134 N. W. 673 (1912).

[32] Note 28, *supra*. See page 135 of the opinion. See also WISCONSIN STAT. (1915), chap. 51, § 51.32 (1) (page 867).

[33] WISCONSIN STAT. (1915), chap. 48 *a*, § 1087 *m*–2. 2 (*a*).

[34] See Superior *v.* Allouez Bay Dock Co., note 15, *supra*. See also WISCONSIN STAT. (1915), chap. 48 *a*, § 1087 *m*–5 (2)., and chap. 51.

mined amount is certain to be raised by the state, whatever the methods adopted, is of course open to question. The actual situation may be one in which an income tax is not a substitute for other demands, but is the only feasible method of obtaining additional revenue. But even so, if the income tax does not bear more heavily on interstate business than on local business, there seems to be no controlling reason why the interstate business should be held inviolate, whether the income tax is supplementary to, or in lieu of, other taxes.

The opinion of the Supreme Court in *United States Glue Co.* v. *Oak Creek* [35] shakes the criticism heretofore [36] passed upon *Baldwin Tool Works* v. *Blue*,[37] in which the federal district court for the northern district of West Virginia sustained the West Virginia excise on corporations. Judge Pritchard supported the inclusion of net receipts from interstate commerce on the authority of the decisions approving the assessment of railroad property by capitalizing net earnings,[38] and sanctioning a gross-receipts tax in lieu of others.[39] He appears to minimize the issue unduly when he says:

"While the statute imposes a special tax in addition to other license taxes, ascertained in some instances by the income that may arise in interstate transactions, nevertheless this is not a tax upon interstate commerce, nor can we conceive of any theory upon which it may be properly said to be a burden upon interstate commerce." [40]

Judge Pritchard evidently proceeds upon the familiar and somewhat exploded distinction between the subject and the measure of the tax, when he argues that "the fact that the measure of that tax may be determined partly from the business of an interstate character could not be said to be such an interference with interstate commerce as to render the act unconstitutional." [41] He does not mention *Galveston, H. & S. A. Ry. Co.* v. *Texas*,[42] nor indicate

[35] Note 2, *supra*.

[36] 31 HARV. L. REV. 760–75. In making this criticism, the writer proceeded on the assumption that there was no distinction between an excise measured by net earnings and one measured by gross receipts.

[37] 240 Fed. 202 (1916).

[38] Cleveland, C., C. & St. L. Ry. Co. *v.* Backus, 154 U. S. 439, 14 Sup. Ct. Rep. 1122 (1894).

[39] United States Express Co. *v.* Minnesota, 223 U. S. 335, 32 Sup. Ct. Rep. 211 (1912).

[40] 240 Fed. 202, 205 (1916).

[41] *Ibid.*, 206.

[42] 210 U. S. 217, 28 Sup. Ct. Rep. 638 (1908), 32 HARV. L. REV. 385 *ff.*

that he would have decided differently had the tax been measured by gross, rather than by net, income. But the distinction between the two, elaborated and relied on by the Supreme Court in the Oak Creek case, may be found sufficient to support the West Virginia excise, even though it falls only on corporations and is in addition to other demands.

As to corporations engaged partly in local business, there is no question of taxability, and the measure of the tax may be forgiven on the ground of its indirect effect on interstate commerce and the remnant of arbitrary power over domestic corporations and over the local business of foreign corporations. Where this arbitrary power has thus far been curbed, the complaint was against the extra-territorial incidence of the tax.[43] In view of the decision in the Oak Creek case that a general tax on net income does not regulate interstate commerce by including income from that commerce, an excise on all corporations may be deemed to have sufficient generality to be accorded similar recognition. Some weight, however, should be given to the probability that the exemption of farmers, merchants and others conducting business as individuals from burdens borne by corporations will tend to relieve a considerable proportion of local business from demands that few engaged in interstate commerce will escape. Here is a fighting chance for the contention that an income tax applicable only to corporations must by and large bear more heavily on interstate business than on local business, and therefore amounts to an unconstitutional regulation of interstate commerce.

Foreign corporations engaged exclusively in interstate commerce have still a stronger ground on which to resist the West Virginia tax. For anything thus far decided, such corporations would seem still to have the shield that they are not subject to an excise tax, no matter how it is measured. The subject selected for taxation has long been regarded as immune from the jurisdiction of the state. If the Cheney Brothers Company [44] and the York Manufacturing Company [45] were permitted to disregard the corporation laws of Massachusetts and of Texas respectively, because they

[43] See 32 HARV. L. REV. 384–417. See also Henderson, "The Position of Foreign Corporations in American Constitutional Law," 2 HARVARD STUDIES IN JURISPRUDENCE, chapters VII, VIII, and IX.

[44] Cheney Brothers Co. *v.* Massachusetts, note 12, *supra.*

[45] York Manufacturing Co. *v.* Colley, note 12, *supra.*

were foreign corporations engaged exclusively in interstate commerce, it would seem to follow that they and those like them are similarly immune from West Virginia's excise on corporations. It cannot be said of this tax, as Mr. Justice Pitney said of the Wisconsin income tax, that "such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property." [46] The subject taxed is not income, but doing business in corporate form. The tax does not fall on "net incomes from whatever source arising," but only on net incomes arising from the exercise of corporate functions. When those functions are exclusively interstate commerce, and the corporation is foreign rather than domestic, a tax on the exercise of those functions is called a tax "on interstate commerce itself," and therefore without the fold of state power.

There can be no question that this is a correct statement of the law to be induced from the Supreme Court decisions to date. Whether the law will continue as it now is does not admit of the same confident assertion. If we assume that foreign corporations engaged exclusively in interstate commerce may be subjected to a general state tax on net income,[47] and that foreign corporations engaged in combined local and interstate commerce cannot exclude interstate income from a state excise on all corporations measured by their net income from all business within the state,[48] there seems no reason in sense or in economics why a foreign corporation engaged exclusively in interstate commerce should be relieved from an excise imposed equally on all corporations. Their interstate income should be no more sacrosanct than is that of the foreign corporations which are fortunate or unfortunate enough to enjoy some local income in addition. But the West Virginia statute calls its exactions on corporations "an annual special excise tax for the privilege of carrying on or doing business in the state"; [49] and under all the law that we know from existing cases the privilege of carrying on interstate commerce alone or the doing of interstate business alone is not a taxable subject. West Virginia does not impose its tax "on net income" received by corporations, but "on

[46] *Cit. supra*, note 9.

[47] See *supra*, pages 636–39.

[48] See *supra*, pages 645–46.

[49] The West Virginia statute is quoted more at length in 31 HARV. L. REV. 761.

the privilege of carrying on . . . business." The net income is the "measure," and not the "subject," of the tax. Granting *arguendo* that the net income of all corporations from whatever source derived is a proper subject of state taxation, that is not the legal *res* which West Virginia has named as the object of its desire. The Supreme Court must rewrite the West Virginia statute in order to escape from the decisions [50] which hold that interstate commerce, whether done by individuals or by corporations, is not a legitimate subject of state taxation.

The court has consistently declined to rewrite statutes or ordinances imposing specific taxes on the privilege of doing any business whatever,[51] even though the identical tax might be imposed on local business alone.[52] It has, however, held that the nominal subject of the tax was not the actual subject, when taxes purporting to be on the privilege of a foreign corporation to engage in local business have been discovered to be substantially taxes on extra-state property of the corporation because measured by total capital stock.[53] The developments since 1910 show the waning of the once controlling influence of the formal distinction between the subject and the measure of the tax. Unless the court is to be more zealous to discover vice than virtue, it may as easily hold that a tax in substance laid on the net income of all corporations will be dealt with as such a tax, in spite of the fact that it is called by the statute an annual special excise for the privilege of carrying on business.

Precedent for such action is not wanting. In *Postal Telegraph Cable Co.* v. *Adams*,[54] as we have seen, a tax described by the statute as a privilege tax was held to be a levy on the property of the company and therefore a valid demand. Similar courtesies have been shown to other taxes found to be in lieu of property taxes.[55] If a

[50] Some of these decisions are cited in 32 HARV. L. REV. 380, note 34.

[51] Cases cited in 32 HARV. L. REV. 411, note 146.

[52] Osborne *v.* Florida, 164 U. S. 650, 17 Sup. Ct. Rep. 214 (1897). See *infra*, pages 669–70.

[53] 31 HARV. L. REV. 584–618, considering the Western Union case and those following it.

[54] 155 U. S. 688, 15 Sup. Ct. Rep. 268 (1895); 32 HARV. L. REV. 249.

[55] See 32 HARV. L. REV. 389. For an instance of judicial rewriting of a statute to relieve a tax of the charge of being an imposition on an instrumentality of the federal government, see Western Union Telegraph Co. *v.* Massachusetts, 125 U. S. 530, 8 Sup. Ct. Rep. 961 (1888), 32 HARV. L. REV. 239.

verbal defect was forgiven in these cases, there is no apparent common-sense reason why it should not be forgiven in West Virginia's excise on corporations. Once it is granted that a tax on the net income of all corporations need not loose its hold when it comes to income from interstate commerce, even though such income is all that a complaining foreign corporation receives, there is no substantial ground for sparing such income because the tax calls itself an excise on doing business rather than a tax "on net income received by corporations." It is to be anticipated, therefore, that the Supreme Court, if it determines to treat a tax on corporate income in the same way that it regarded Wisconsin's tax on all income, will find little difficulty in taking the further step that a tax, though formally on the business itself, is substantially on the net income from that business and is therefore entitled to the same consideration that would be bestowed on a tax designated as one on such net income.

There remains for consideration the bearing of the commerce clause on complaints of the vice of extra-territoriality in the assessment of an income tax. It has already been suggested that the legal status of the recipient of income may be a factor in cases where it is objected that a state has levied on income from extra-state sources or on income to which extra-state activities have contributed. In dealing with such complaints it will be necessary to determine what basis or bases of jurisdiction underlie the imposition of income taxes. The Western Union case and those following it establish that the taxation of foreign corporations engaged in interstate commerce by a method which takes account of extra-state values is an invalid regulation of interstate commerce as well as a denial of due process of law. This doctrine must apply to taxes on income or to taxes measured by income as forcibly as to taxes measured by property. Plainly foreign corporations engaged wholly or partly in interstate commerce can insist that extra-state income as well as extra-state property is beyond the reach of the state by direct or indirect action.

What can be done with foreign corporations engaged exclusively in local business does not fall strictly within the scope of this study, although the cases that have been reviewed are the ones which throw light on the problem. If *Horn Silver Mining Co.* v. *New York*[56]

[56] 143 U. S. 305, 12 Sup. Ct. Rep. 403 (1892).

is still law, it would seem that such foreign corporations may be subjected to an excise measured by their total income as readily as to one measured by their total capital stock. The possibility of the early demise of the Horn case has already been suggested.[57] Mr. Henderson in his admirable study of *The Position of Foreign Corporations in American Constitutional Law*[58] argues forcibly for the view that the decision must be regarded as already abandoned.[59] This is a legitimate inference from the opinion of Mr. Justice Van Devanter in *International Paper Co.* v. *Massachusetts*,[60] in which the due-process objections to an excise measured by extra-territorial values appear to be treated as entirely independent of the commerce clause. The opinion of Mr. Justice Holmes in *Equitable Life Assurance Society* v. *Pennsylvania*[61] may also be taken as an implied obituary of the Horn case. This case sustained a tax on a foreign insurance company which included a percentage of premiums paid in other states on policies on the lives of residents of the taxing state, notwithstanding the ruling that such premiums, separately considered, afford no basis for a tax on a company that has ceased to solicit business or to collect premiums in the taxing state.[62] Though the Equitable case came within the doctrine of arbitrary power declared in the Horn case, it was not put on that ground by the court. Instead, Mr. Justice Holmes pointed out that many incidents of the contracts insuring the lives of residents were likely to be attended to in Pennyslvania, such as the payment of dividends and the adjustment of claims, and added:

"It is not unnatural to take the policy holders residing in the State as a measure without going into nicer if not impracticable details. Taxation has to be determined by general principles, and it seems to us impossible to say that the rule adopted in Pennsylvania goes beyond what the Constitution allows."[63]

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[57] 31 HARV. L. REV. 613, 758, 759.

[58] Henderson, "The Position of Foreign Corporations in American Constitutional Law," 2 HARVARD STUDIES IN JURISPRUDENCE, Cambridge, Harvard University Press, 1918.

[59] For a statement of Mr. Henderson's argument, and a presentation of considerations against its validity as an expression of the present state of the law, see 33 POLITICAL SCIENCE QUARTERLY, 558–65.

[60] 246 U. S. 135, 38 Sup. Ct. Rep. 292 (1918).

[61] 238 U. S. 143, 35 Sup. Ct. Rep. 829 (1915).

[62] Provident Savings Life Assurance Society *v.* Kentucky, 239 U. S. 103, 36 Sup. Ct. Rep. 34 (1915).

[63] 238 U. S. 143, 147, 35 Sup. Ct. Rep. 829 (1915).

Here is a pretty plain implication that an excise measured by premiums which have no relation whatever to the taxing state would have gone beyond what the Constitution allows. The states, therefore, have had a clear warning of the risks they run in seeking to levy on the extra-state income of any foreign corporation.

Such taxation of extra-state income can be justified, if at all, only by the possession of some power over the recipient. The income, as such, is not taxable by a state which has no other relation towards it than that of covetousness. It is at best exceedingly doubtful whether the requisite power exists over any foreign corporation. As to domestic corporations the case is not so clear. Such corporations, whatever their business, may be subjected to any demand exacted as a price for the privilege of coming into being.[64] Through control over the corporate entity *en ventre sa mère*, the state may accomplish indirectly what it cannot attain directly. With reserved power to amend or repeal the corporate charter, this initial arbitrary power may possibly be transformed into a continuing one. But, if so, it must be exercised as an assertion of such arbitrary power, or else find adequate justification on independent grounds. This appears clearly from Mr. Justice Harlan's opinion in *Louisville & Jeffersonville Ferry Co.* v. *Kentucky*,[65] in which it was held a taking of property without due process of law to include in the valuation of the Kentucky franchise of an interstate ferry the value of the Indiana franchise of the same concern. After stating the conclusion that Kentucky cannot in effect tax the incorporeal hereditament which has its situs in another state, Mr. Justice Harlan continues:

"This view is not met by the suggestion that Kentucky can make it a condition of the exercise of corporate powers under its authority that

[64] Railroad Co. *v.* Maryland, 21 Wall. (U. S.) 456 (1874), 31 HARV. L. REV. 578; Ashley *v.* Ryan, 153 U. S. 436, 14 Sup. Ct. Rep. 865 (1894), 31 HARV. L. REV. 580; Kansas City, M. & B. R. Co. *v.* Stiles, 242 U. S. 111, 37 Sup. Ct. Rep. 58 (1916), 31 HARV. L. REV. 599. The same rule is assumed to apply to charter requirements of a police nature. Louisville & N. R. R. Co. *v.* Kentucky, 161 U. S. 677, 16 Sup. Ct. Rep. 714 (1896). But intimations that some or all of the justices have doubts as to whether charter provisions may inevitably be enforced under all future circumstances appear in Interstate Consolidated Street Railway Co. *v.* Massachusetts, 207 U. S. 79, 28 Sup. Ct. Rep. 26 (1907), International & G. N. Ry. Co. *v.* Anderson County, 246 U. S. 424, 38 Sup. Ct. Rep. 370 (1918), and Detroit United Ry. Co. *v.* Detroit, 39 Sup. Ct. Rep. 151 (1919).

[65] 188 U. S. 385, 23 Sup. Ct. Rep. 463 (1903).

the tax upon the franchise granted by it shall be measured by the value of all its property, wherever situated, of whatever nature, or from whatever source derived. It is a sufficient answer to this suggestion to say that no such condition was prescribed in the charter of the ferry company when it was granted and accepted. Nor does the taxing statute in question make it a condition of the ferry company's continuing to exercise its corporate powers that it shall pay a tax for its property having a *situs* in another State. There is no suggestion in the company's charter that the State would ever, in any form, tax its property having a *situs* in another State. We express no opinion as to the validity of such a condition if it had been inserted in the company's charter, or if it were now, in terms, prescribed by any statute. We decide nothing more than it is not competent for Kentucky, under the charter granted by it, and under the Constitution of the United States, to tax the franchise which its corporation, the ferry company, lawfully acquired from Indiana, and which franchise or incorporeal hereditament has its *situs*, for purposes of taxation, in Indiana." [66]

Owing to this disposition of the case, the court did not consider whether the tax complained of was an unlawful burden on interstate commerce.

Thus the court leaves open the question whether a state may tax domestic corporations as it pleases, provided it specifically bases its demand on its control over the continued existence of the corporation. This question was left open also by *Kansas City, M. & B. R. Co.* v. *Stiles*,[67] which was careful to adduce in support of an excise measured by total capital stock the fact that the law was in force when the corporation begged for birth.[68] The Supreme Court is still free to apply the doctrine of the Western Union case to domestic corporations which are not under some fairly clear contractual disability to object to the demand complained of. Whether it will do so is still uncertain. Whether it should do so is a question on which disagreement is not difficult. In the opinion of the writer, the less we have in our constitutional law of arbitrary power on the part of one state to deal as it will with affairs in other states, the better. If a tax is not constitutional by

[66] 188 U. S. 385, 23 Sup. Ct. Rep. 398 (1903). [67] Note 64, *supra*.

[68] For example, the passage quoted in 31 HARV. L. REV. 599: "The railroads comprising this consolidation entered upon it with the Alabama statute before them and under its conditions, and, subject to constitutional objections as to its enforcement, they cannot be heard to complain of the terms under which they voluntarily invoked and received the grant of corporate existence from the state of Alabama."

reason of its own intrinsic merit or absence of sufficient demerit, there is something artificial and unwholesome in making it constitutional by endowing a state with a club which it may brandish at will. A tax on the extra-state income of a domestic corporation, if not good as an exercise of the taxing power, does not, as an original proposition, present a strong claim for recognition as an exercise of unlimited power over corporate creatures. It no longer fits the facts to treat the grant of a corporate charter as a bestowal of gracious favor by an act of high prerogative. In most instances it is today a mere record of a situation that by common consent is one demanded by the exigencies of normal business intercourse.[69]

Even if it is held that a state is subject to limitations in wielding the taxing power by way of the amendment of corporate charters, there still remains the question whether a tax on the total net income of a domestic corporation can not stand on its own legs. New York,[70] Wisconsin,[71] Montana,[72] Connecticut [73] and West Virginia [74] ask domestic corporations to pay only on the income earned from business within the state, or on the proportion of total income roughly estimated to have been earned within the state. Montana, *ex abundantia cautelae* or inspired by benevolence, excludes income from interstate commerce. Missouri [75] and Virginia,[76] however, take toll from all income no matter whence derived. As the profits from local or interstate commerce in other states increase, the revenues of the chartering state wax correspondingly. A historian might be reminded of a famous tea party, but we are thinking of the Constitution that followed after. Should the fact that the recipient of extra-state income is a domestic corporation justify a tax on that income? If such income is

[69] For elaboration of this position, to which the writer acknowledges his indebtedness, see Gerard Carl Henderson, "The Position of Foreign Corporations in American Constitutional Law," 2 HARVARD STUDIES IN JURISPRUDENCE, chap. X. While Mr. Henderson is dealing primarily with foreign corporations, his analysis, it is submitted, applies in considerable degree to domestic corporations as well.

[70] LAWS OF NEW YORK (1917), chap. 726, § 214. See note 91, *infra*, for reference to later amendment.

[71] See note 91, *infra*.

[72] LAWS OF MONTANA (1917), chap. 79.

[73] ACTS OF 1915, chap. 292; GENERAL STATUTES OF CONNECTICUT (Revision of 1918), chap. 73, §§ 1391, 1394.

[74] ACTS OF WEST VIRGINIA, Second Extraordinary Session, 1915, chap. 3.

[75] LAWS OF MISSOURI, 1917, 528. S. B. 415, § 7.

[76] 4 VIRGINIA CODE ANNOTATED (Supplement, 1916), 552.

from interstate commerce, is a tax thereon a regulation of that commerce "in a constitutional sense"?

In considering the question, let us assume that an individual may be taxed at his domicil on all net income which comes to his coffers, for so the law is likely to be. It does not accord with traditional views of the law to declare that a state's power over artificial persons of its own creation is less than that over man that is born of woman. Nevertheless it is submitted that the Supreme Court would do well so to hold with respect to the matter now under consideration. A corporation does not send its children to school; it does not vote for governor; it does not make a will; it does not marry or give in marriage. It is a business mechanism, and nothing more. It is a medium by which income is made and distributed. In so far as the process is local to the taxing state, the fruits thereof should be taxed. But there are several reasons which justify taxing an individual on his total net gain at the place where he makes his permanent home, that do not apply to a similar tax on a corporation. The individual is the terminus of the income. The termini of corporate income are often individuals in other states. The assimilation of a corporation to a natural person may for many purposes be a convenient fancy, but it should not blind us to essential differences that ought for other purposes to be controlling. The crucial question is whether business, as business, should be taxed elsewhere than where it is carried on. It is agreed that it should be taxed there. If it is taxed elsewhere as well, the burden is cumulative. When the corporate income passes on to the individuals who are in reality the corporation, it may be taxed again. Granting that some double taxation is necessary, or even desirable, it is possible to have too much of it. No more feasible spot for elision of double taxation can be found than the extra-state income of a corporation. The majority of the states which have thus far imposed taxes on the net income of corporations have discovered this for themselves. While the constitutionality of such reaping where a state has not sown is still undetermined, the Supreme Court would do well to consider the problem in all of its practical bearings, and not follow blindly some metaphysical conceptions of the nature of the corporate entity and questionably broad declarations as to the power of a state over its mystical being.

It has already been recognized that natural persons stand in a different relation to the state of their choice than does a corporation. From domiciled individuals a state may with propriety exact tribute from all their gains. No serious question is likely to arise as to the taxation at the domicil of the recipient of income from intangibles which are relieved of other burdens. If the property is taxable to the owner on the principle of *mobilia sequuntur personam*,[77] the income therefrom should receive similar treatment. But income from extra-state realty and from extra-state business may conceivably stand on a different footing. A tax on the former is not likely to raise any question under the commerce clause, even when the recipient is engaged in interstate commerce. His interstate business is not less profitable because he gets less from other sources. The only complaint against a tax on income from extra-state realty would be based on the denial of due process of law. The argument would be that, as the source of the income is beyond the jurisdiction, the income is also. *Pollock* v. *Farmers' Loan & Trust Co.*[78] would naturally be relied on to support such a contention, but the issue in that case can be distinguished from that now under consideration. The source of income may determine whether a tax thereon is a direct or indirect tax within the meaning of the fourth clause of Article I, section 9, of the federal Constitution,[79] and still not determine whether there is state jurisdiction within the limitations of the Fourteenth Amendment. An expression of Mr. Justice Holmes in the latest case on the taxation of intangibles to their owner at his domicil has possibilities of application to the taxation of income:

"The present tax is a tax upon the person, as is shown by the form of the suit, and is imposed, it may be presumed, for the general advantages of living within the jurisdiction. These advantages, if the State

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[77] Kirtland *v.* Hotchkiss, 100 U. S. 491 (1879), is the leading case. See Charles E. Carpenter, "Jurisdiction over Debts for the Purpose of Administration, Garnishment, and Taxation," 31 HARV. L. REV. 905, for the most recent review of the authorities.

[78] 158 U. S. 601, 15 Sup. Ct. Rep. 912 (1895). This case held that a tax on the income from land is the same as a tax on the land itself from the standpoint of the question whether the tax is direct or indirect.

[79] "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." This provision is modified, in so far as its application to taxes on income, by the Sixteenth Amendment.

so chooses, may be measured more or less by reference to the riches of the person taxed." [80]

To this is added:

"It is unnecessary to consider whether the distinction between a tax measured by certain property and a tax on that property could be invoked in a case like this. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 146, 162 *et seq.* Whichever this tax technically may be, the authorities show that it must be sustained." [81]

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[80] Fidelity & Columbia Trust Co. *v.* Louisville, 245 U. S. 54, 58, 38 Sup. Ct. Rep. 40 (1917).

[81] *Ibid.*, 59. This passage was quoted by Chief Justice Rugg of the Massachusetts supreme court in Maguire *v.* Tax Commissioner, 230 Mass. 503, 510–11, 120 N. E. 162 (1918), which sustained the power of Massachusetts to tax income received by a Massachusetts *cestui* from a Pennsylvania trust. "That reasoning," said the Chief Justice, "appears to us to be equally applicable to the facts here disclosed. . . . It is of no consequence in this aspect whether the tax is levied on income in truth received by the resident taxpayer from intangible property held for his benefit by a trustee resident in a sister State or on intangible property owned by the taxpayer but all in fact kept by him in a sister State. There is not apparent to us any difference in principle between the two cases" (230 Mass. 503, 511).

It is interesting to note that the Massachusetts court calls the income tax a property tax and justifies it as such, and then adds further justification which seems to proceed on the notion that it is tax on the person rather than one on property. Evidently the nomenclature is not of controlling importance. Substantial considerations of public policy appear to be the basis on which the taxability of residents on income from extra-state sources is sustained. The pertinent paragraphs of the opinion are as follows: "The *cestui que trust* has important legal rights respecting the trust fund which are personal to her. They are rights in the nature of property. They cannot be taken away from her by arbitrary or irrational procedure. They attach to her person wherever she goes. One of these is the right to receive the income. That is a property right. The income when received is property. The tax here in question is a property tax. *Tax Commissioner* v. *Putnam*, 227 Mass. 522, 531, 532. Whether it be regarded as a tax on the right of the *cestui que trust* or a tax on the income as received, in either event a property tax is permissible. Of necessity a tax on income requires time as an element in its calculation. It must be levied on the income received during a period of time. It is not necessary that income be reinvested before it can be taxed. It may be spent as received and yet be subject to taxation. The contention of the petitioner in principle reaches much further than to the facts of the present case. In its logical application and extension it apparently would render invalid income from annuities, certificates in partnerships, associations and trusts, and perhaps other sources, originating in sister States, and not having a place of business in this Commonwealth. Of course, if the principle is sound, its disturbing effect is no argument against its recognition and adoption. But a contention which in its results would seriously cripple the practical operation of any comprehensive system of State income taxation has no presumption in its favor and ought not to be adopted except because of compelling considerations. We perceive no such requirement as to the tax here in controversy. Whatever may be the effect of *Pollock*

The Stone Tracy case sustained the federal corporation tax of 1909 and sanctioned the inclusion of income from municipal bonds and other securities not directly taxable by the federal government. The distinction between the subject and the measure of the tax was the magician's wand used to wave away crucial difficulties and avoid analysis of pertinent issues. Referring to *Galveston, H. & S. A. R. Co.* v. *Texas* [82] and *Western Union Telegraph Co.* v. *Kansas* [83] Mr. Justice Day declared authoritatively:

"There is nothing in these cases contrary, as we shall have occasion to see, to the former rulings of this court which hold that where a tax is lawfully imposed upon the exercise of privileges within the taxing power of the State or Nation, the measure of such tax may be the income from the property of the corporation, although a part of such income is derived from property in itself non-taxable. The distinction lies between the attempt to tax the property as such and to measure a legitimate tax upon the privileges involved in the use of such property." [84]

Whether this distinction survived the Western Union case in sound logic we need not pause to inquire. It is enough for our present purpose that it survived that case in the mind of the Supreme Court. It is still available as an ever-present help in time of logical trouble. It is quite as applicable to a state tax on the privilege of its citizens to be domiciled within the jurisdiction as to a federal tax on doing business in corporate form. If it seems wise to measure a personal income tax by all income, from whatever

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v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 581; S. C. 158 U. S. 601, and *Brushaber* v. *Union Pacific Railroad*, 240 U. S. 1, 16, 17, upon the nature of the tax here in question under the Constitution of the United States, no binding decision appears to us to require that this tax be declared invalid. There is nothing inconsistent with the conclusion here reached in *Walker* v. *Treasurer & Receiver General*, 221 Mass. 600.

"The income tax is measured by reference to the riches of the person taxed actually made available to him for valuable use during a given period. It establishes a basis of taxation directly proportioned to ability to bear the burden. It is founded upon the protection afforded to the recipient of the income by the government of the Commonwealth of his residence in his person, in his right to receive the income, and in his enjoyment of the income when in his possession. That government provides for him all the advantages of living in safety and in freedom and of being protected by law. It gives security to life, liberty, and the other privileges of dwelling in a civilized community. It exacts in return a contribution to the support of that government measured by and based upon the income, in the fruition of which it defends him from unjust interference" (*Ibid.* 512–13).

[82] 210 U. S. 217, 28 Sup. Ct. Rep. 638 (1908), 32 HARV. L. REV. 385 *ff.*

[83] 216 U. S. 1, 30 Sup. Ct. Rep. 190 (1910), 31 HARV. L. REV. 584 *ff.*

[84] 220 U. S. 107, 163–64, 31 Sup. Ct. Rep. 342 (1911).

source derived, the Supreme Court has at its right hand the necessary formula to support the exaction. If it seems unwise, the Western Union case and those following it are within easy reach of the left hand to find constitutional defects.

It is to be anticipated that the right hand will be chosen for dealing with income from extra-state realty. If the mortgagee of such realty may be taxed at his domicil on the obligation of the mortgagor,[85] it is hard to see why the owner should not make a contribution from his rent. A more serious question arises in respect to income from extra-state interstate commerce. Unless all signs fail, such income will be held taxable where the commerce is carried on.[86] Ought the same income from interstate commerce to be taxed by two states on different conceptions as to what is being taxed? It is too late to raise the general question whether bi-state double taxation should be allowed at all. The Supreme Court has not seen its way to declare that such double taxation is inconsistent with the Constitution.[87] But it has several times scotched double taxation of interstate commerce by a single state.[88] In these instances, however, the court was not dealing with taxation that fell on all business and all persons alike. It had before it the possibility or actuality of heavier burdens on interstate commerce than on other business. Where this possibility is foreclosed by general state taxation on all personal incomes received by citizens and on all business incomes from business within the territory, there is strong ground for the contention that interstate commerce should not be subsidized by exemption from burdens that other business must bear. Such a contention seems in substantial accord with the analysis of the results reviewed in this study.

Where power over the person is lacking, and an income tax must depend for its validity on power over the income itself, it is clear that extra-state income must be excluded from the computation.[89] Without doubt the Supreme Court will soon be called upon

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[85] Kirtland *v.* Hotchkiss, note 67, *supra.*

[86] See *supra*, pages 635–40.

[87] The cases are reviewed in Mr. Carpenter's article cited in note 77, *supra.*

[88] Fargo *v.* Michigan, 121 U. S. 230, 7 Sup. Ct. Rep. 857 (1887); Western Union Telegraph Co. *v.* Texas, 105 U. S. 460 (1881); Galveston, H. & S. A. Ry. Co. *v.* Texas, 210 U. S. 217, 28 Sup. Ct. Rep. 638 (1908), 32 HARV. L. REV. 385 *ff.*; Meyer *v.* Wells, Fargo & Co., 223 U. S. 298, 32 Sup. Ct. Rep. 218 (1912).

[89] This is the rule as to chattels, even when there is power over the owner. Union

to solve some pretty problems with respect to the so-called "situs" of income. Nonresidents and foreign corporations will seek support from the Fourteenth Amendment and the commerce clause for complaints that states have allocated to themselves more income than belongs to them. When all the transactions out of which the income arises are in a single state, the disputes will not present great difficulty. But when the income-producing activities straddle two states, and the acts in neither alone would yield the income, there is room for perplexity. The importance of the problem justifies a review of two cases which bear upon it, though neither touches it precisely, since in one the taxpayer was a domestic corporation, and in the other there was no element of interstate commerce.

The first case is the decision of the Wisconsin supreme court in

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Refrigerator Transit Co. *v.* Kentucky, 199 U. S. 194, 26 Sup. Ct. Rep. 36 (1905); Delaware, L. & W. R. R. Co. *v.* Pennsylvania, 198 U. S. 341, 25 Sup. Ct. Rep. 669 (1905). It is also the rule as to such an incorporeal hereditament as a franchise to run a ferry. Louisville & Jeffersonville Ferry Co. *v.* Kentucky, 188 U. S. 385, 23 Sup. Ct. Rep. 463 (1903). The opinion in the Union Refrigeratof case says that it has always been understood that the rule is the same as to extra-state realty. In all of the cases sustaining the taxation of choses in action, there was either power over the creditor or over some economic value behind the chose in action, or over some incidents thereof.

The following excerpts from Mr. Justice Brown's opinion in the Union Refrigerator case are clearly applicable, *mutatis mutandis*, to income taxation:

"The power of taxation, indispensable to the existence of every civilized government, is exercised upon the assumption of an equivalent rendered to the taxpayer in the protection of his person and property, in adding to the value of such property, or in the creation and maintenance of public conveniences in which he shares. . . . If the taxing power be in no position to render these services, or otherwise to benefit the person or property taxed, and such property be wholly within the taxing power of another State, to which it may be said to owe an allegiance and to which it looks for protection, the taxation of such property within the domicil of the owner partakes rather of the nature of an extortion than a tax, and has been repeatedly held by this court to be beyond the power of the legislature and a taking of property without due process of law. . . .

"The argument against the taxability of land within the jurisdiction of another State applies with equal cogency to tangible personal property beyond the jurisdiction. It is not only beyond the sovereignty of the taxing State, but does not and cannot receive protection under its laws. True, a resident owner may receive an income from such property, but the same may be said of real estate within a foreign jurisdiction. Whatever be the rights of the State with respect to the taxation of such income, it is clearly beyond its power to tax the land from which the income is derived." 199 U. S. 194, 202–04.

There can be no doubt whatever that power over and protection of the recipient or the sources of income will be held essential to jurisdiction to levy an income tax.

United States Glue Co. v. *Oak Creek* [90] — the same controversy which presented the income-tax problem to the United States Supreme Court. The Wisconsin law aimed to tax no "business income" that was not earned within the state, whether received by residents or non-residents.[91] The United States Glue Company did not contest before the state court the taxability of its income from rentals and intangibles,[92] nor does the case state the sources from which such income was derived. The matter in controversy was the income from sales. With the contention that such income was not taxable because of the commerce clause, we are no

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[90] 161 Wis. 211, 153 N. W. 241 (1915).

[91] WISCONSIN STATUTES (1915), chap. 48 *a*, § 1087 *m*–2 (3). "With respect to other income, persons engaged in business within and without the state shall be taxed only upon such income as is derived from business transacted and property located within the state, which may be determined by an allocation and separate accounting for such income when made in form and manner prescribed by the tax commission, but otherwise shall be determined in the manner specified in subsection (*e*) of subsection 7 of section 1770 *b* of the statutes, as far as applicable." The section referred to prescribed a form of "unit rule," which applied the ratio between the sum of the gross business in dollars plus the value of the property in dollars within the state to an aggregate of the same two elements in all the states in which business was done.

New York has a somewhat more complicated rule of apportionment for its corporate income tax. In getting its ratio it takes account of the aggregate of the average monthly value of real property, chattels, bills and accounts receivable, and stocks of other corporations within the state and the aggregate of the same elements in all the states. LAWS OF NEW YORK, 1918, chap. 417, § 214 (vol. 2, 1262); BIRDSEYE'S CONSOLIDATED LAWS OF NEW YORK, 1918 Supplement, 661.

In the Wisconsin cases which have been found, the ratio method was not employed. In the Oak Creek case, specific consideration was given to the income from various sources. In State *ex rel.* Brenk *v.* Widule, 161 Wis. 396, 154 N. W. 696 (1915), an inheritance of foreign realty was held to be from sources without the state, and therefore the court did not decide whether it was "income" within the meaning of the statute. In State *ex rel.* Arpin *v.* Eberhardt, 158 Wis. 20, 147 N. W. 1016 (1914), income received by a resident from a partnership whose business and property was wholly without the state was held not taxable under the statute. In commenting on the statute, Judge Barnes said:

"Certain considerations occur to us which might have induced the legislature to refrain from taxing income derived from sources without the state except as specified. It was no doubt the desire of the legislature to prevent the loan or investment of moneys without the state for the purpose of receiving a fixed return for the investment made so as to avoid the payment of a tax on this species of property. The property of this firm was taxable in the state where located. If incomes were taxed in that state, the income would also, in all probability, be taxed there. If the income were taxed here, it might be doubly taxed. Conceding the right to impose such double taxation, the legislature might well feel that it would not be just to do so. Other considerations might be mentioned, but those suggested should suffice." 158 Wis. 26, 23–24.

[92] 161 Wis. 211, 215 (1915).

longer concerned. Our present interest is in the objection that the income from some of these sales was not derived from business transacted and property located within the state, and so not within the terms of the Wisconsin statute.

The income covered by these objections included (1) that from goods sold and delivered from the Wisconsin factory to persons outside the state; (2) that from products of the Wisconsin factory shipped to extra-state branch houses and from there sold to customers outside Wisconsin; and (3) that from goods bought without the state, shipped to extra-state branches either directly or by way of the Wisconsin factory, and then sold and delivered from the extra-state branches to extra-state customers.[93] As to this last class of business the Wisconsin court held that the income therefrom was not from business or property within Wisconsin. But Wisconsin was declared to be the source of all income from sales of products of the Wisconsin factory including those of goods disposed of from the branch houses in other states. After saying that "the place of sale of such products does not change the place of business from this to the state where the goods are sold," [94] Judge Siebecker continued:

"The transactions involved in producing the products at the plant at Carrollville and disposing of them through intra-state or interstate transactions are in substance and effect transacting business in this state, and the shipping and delivery of such goods on sales made at home or abroad, from either the factory or branch houses to which they had been shipped before sale, are no more than incidents in transacting the business of supplying the articles to customers in their finished state. We cannot, in the light of the nature of the general conduct of the business, assent to the claim that the shipping and delivery of goods, manufactured at the plant, from branch houses are the controlling elements of such transactions and that they give such business a situs without the state. The manufacture, the management, and the conduct of the business at the home office are the controlling features in the process of disposing of the article produced at the factory and constitute the source out of which the income issues and give it a situs within the state under the Income Tax Law." [95]

This view of the "situs" of income invites examination. If the professed basis of the Wisconsin tax on business income is not

[93] 161 Wis. 213–14, 153 N. W. 241 (1915).
[94] *Ibid.*, 218. [95] *Ibid.*

the subjection of the recipient to the power of Wisconsin, but the actual earning of the income in Wisconsin, Judge Siebecker dismisses too cavalierly the alleged importance of the transactions without the state. The sales in another state to customers in that state are taxable in that jurisdiction as intra-state sales.[96] If the United States Glue Company is a wholesaler in Chicago as well as a manufacturer at Carrollville, Wisconsin, it must be subject to an Illinois income tax on all its Illinois business, unless the Supreme Court is going to insist that power over the person is the only basis on which income taxes may be levied. Even such insistence would not forbid Illinois taxation of Illinois intra-state sales. And if income from interstate commerce carried on by non-residents or by foreign corporations may be included in a state-wide tax on business income, Illinois may lay a tax on income from sales by Illinois wholesalers to customers in other states, even though the sales are of goods manufactured by the wholesaler at a Wisconsin factory. Plainly enough the manufacture, the wholesale establishment and the work of securing customers and of collecting bills are all essential to the making of a profit. No one of these three elements in the combined enterprise is a mere incident. A portion of the net income is due to each element. If sufficiently exquisite book-keeping were possible, each state should take only that portion of the income which is contributed by the acts done within its own borders. Judge Siebecker considers only two extreme alternatives, both of which miss the ideal solution.

It may well be that the ideal solution is not attainable in practice. But this is no reason why it should be neglected in considering what is the best approximation that is feasible. Though manufacturing is for profit, the profit appears only in income from sales. The price which the product brings depends only in part on the excellence of raw materials and of shop management. The need or susceptibility of customers, the skill of the sales force, the wisdom in extending credit and energy in collecting accounts are not mere incidents, as Judge Siebecker would have us believe.[97] Indeed they may in many instances be "controlling" in the

[96] Ratterman *v.* Western Union Telegraph Co., 127 U. S. 411, 8 Sup. Ct. Rep. 1127 (1888).

[97] Judge Siebecker recognizes that these elements are of practical importance (161 Wis. 211, 217), but calls them but "incidents" from a legal standpoint.

sense that they are the factors that make the difference between profit and loss. These factors in interstate sales all occur outside the state of manufacture. The manufacture without the customer would be as vain as the customer without the goods to sell him. The state where the solicitation is done and where accounts must be collected offers to the business the protection of its police officials and its courts. If net income from interstate commerce is no longer to be exempt from state taxation, and if each state where income is earned is to be allowed to levy on that income irrespective of the domicil or legal character of the recipient, it is artificial to insist that either the manufacture or the securing of a customer is a mere "incident" or that either is "controlling," if controlling means of exclusive importance. Judge Siebecker's insistence that the extra-Wisconsin activities of the United States Glue Company were not entitled to legal consideration would have been more compelling if it had been based on the power of Wisconsin over its own corporate creatures. This ground, however, was not open to him under the Wisconsin statute. It does not appear to have been urged before the Supreme Court that the interpretation put upon the statute as to "situs" of the income in question raised an issue under the commerce clause. The Supreme Court might refuse to consider such a question in a case where state power over the recipient of income furnished sufficient justification for the result sanctioned by the state court. But it may be expected that other disputes will bring before the Supreme Court some important constitutional issues over the situs of income.

Another phase of this same problem appears in *Shaffer* v. *Howard*,[98] decided by the federal district court for the Eastern District of Oklahoma. The case involved the application of the Oklahoma income tax to the income of non-residents. Mr. Shaffer was domiciled in Chicago and owned and operated oil wells in Oklahoma. He contended that none of the income from these wells was taxable by Oklahoma, because the state had no power over him personally, and the income was "made up from two inseparable elements — the property and the owner's management and intelligence — and the latter of these is outside the state."[99] To this, Judge Cotteral answered:

[98] 250 Fed. 873 (1918).

[99] 250 Fed. 873, 874 (1918).

"The element of personal ability or services in acquiring the income may be disregarded. It enters into all income and causes the returns from an occupation. But it has not been deemed important in the taxation of property, and need not be deducted from an assessment." [100]

Judge Stone considered the contention more at length. He concedes *arguendo* the contention of the complainant that "it is the recipient of the income that is taxed, not his property," [101] and answers it by saying:

"It does not necessarily follow from this definition that the plaintiff is subject to income tax only in the state of his residence. It means, rather, that he is subject to income taxation only in those jurisdictions which protect him in the production, creation, receipt, and enjoyment of his income. If he lives in Illinois, and has in Oklahoma the property or the business from which his income flows, does not the latter state truly protect him in the privilege of producing, creating, receiving, and enjoying that income when it permits and protects his business from which the income flows? How is that affected by his residence?" [102]

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[100] 250 Fed. 883 (1918).

[101] 250 Fed. 873, 875 (1918). This statement of the complainant's contention is taken from a quotation in his brief from State *ex rel.* Sallie F. Moon Co. *v.* Wisconsin Tax Commission, 166 Wis. 287, 163 N. W. 639 (1917). Judge Campbell, in his dissenting opinion in Shaffer *v.* Howard, relies on this statement of the Wisconsin court and on another from the same tribunal in Manitowoc Gas Co. *v.* Wisconsin Tax Commission, 161 Wis. 111, 152 N. W. 848 (1915).

The Moon case held that income received by a resident stockholder after the effective date of the income tax law was taxable, although its economic source was a surplus in the hands of the corporation prior to that date.

The Manitowoc Gas case held that interest due a non-resident on bonds issued by a domestic corporation was not income "derived from sources within this state" within the meaning of the Wisconsin statute, since "the law levying an income tax upon nonresidents 'upon such income as is derived from sources within the state or within its jurisdiction' must be construed to mean such income as issues directly from property or business located within the state, and not income from loans made therein, though, as here, secured by a trust deed upon property situated within the state" (161 Wis. 111, 115). The inapplicability of the analysis of the Wisconsin tax in this opinion to the problem involved in Shaffer *v.* Howard is evident from an earlier statement of the Wisconsin court in the same case, which reads as follows: "If an income be taxed, the recipient thereof must have a domicile within the state or the property or business out of which the income issues must be situated within the state so that the income may be said to have a situs therein" (161 Wis. 111, 114–15). This deprives the contention of Mr. Shaffer against the Oklahoma tax of any support from the Wisconsin court's interpretation of the basis of the Wisconsin tax. That tax was partly on persons, and partly on income, irrespective of the recipient.

[102] 250 Fed. 873, 875–76 (1918).

In further elaboration of the problem of bi-state income, the learned judge continues:

"Both the property in Oklahoma and the intelligence in Illinois contributed to this income. Each was necessary to the result. Each had protection from the state in which it was. It is impossible to separate the two elements for taxation purposes. It is impossible, if material, to determine which was most potent in the result. Can either state be told it cannot be compensated for its protection of a necessary component element of this income, or that it cannot measure such compensation by that income? If, through accident or design, an individual dwells in one state, while his business is in part or wholly located in other states, so that he needs, commands, and receives the protection of several states, can his income therefrom escape imposition? It may be true that the state which protects the person of the one who creates, receives or enjoys an income may require of him therefor a tax measured by his ability to pay from his entire income. That is no reason why the state which protects the business which contributes to his income may not also demand, as pay for that protection, a tax measured by that part of his income which came from that business. If in the one case the state of residence can tax the right to create, receive, and enjoy an income, why cannot another state tax his right to create and receive an income from business within its borders?" [103]

This seems to be said by way of answer to the complainant's argument rather than as the analysis put upon an income tax by the writer of the opinion. For Judge Stone follows it with the paragraph:

"A tax upon an income of the instant character (from a business) is directed at neither the person who receives nor the property from which the income arises, but at the privilege of making, producing, creating, receiving, and enjoying the income itself. The right to lay such tax depends upon the protection of the person who receives or of the business which helps create that income." [104]

Here seems to be a dual conception of an income tax, though the writer insists that even upon the complainant's conception that the tax is on the recipient, there is jurisdiction over an absent recipient based on the protection of interests of the recipient even if these interests be not those of his body or his castle. It is pointed out that the statute does not seek to create a personal liability

[103] 250 Fed. 876 (1918). [104] *Ibid.*

against non-residents for the payment of the tax, but confines itself to creating a lien on the sources of the income taxed. But, to Judge Stone, direct power of compulsion over the person is not a prerequisite to the levy of a personal tax, provided other essentials are present. On this point he says:

"There is nothing new in this conception of a nonresident being taxed for rights or privileges he exercises under the protection of another state. Inheritance taxes are illustrations. *Mager* v. *Grima*, 8 How. 490, 12 L. Ed. 1168; *Scholey* v. *Rew*, 23 Wall. 331, 23 L. Ed. 99. Such a tax is levied against the nonresident as well as the resident because of his inheritance — the state protects him in that privilege. Occupation or business taxes are also illustrative. And this would be so because the state of Oklahoma permits him to carry on his business within the state, and protects him therein, irrespective of whether he lives within or without the state, or manages the business from within or without the state. When he can be properly taxed for the privilege of inheriting the property or carrying on a business within another state, why cannot he be taxed upon an income he derives from business within the state, when a tax upon such an income as this is a levy on the privilege of producing, creating, receiving and enjoying an income? It is true the tax on the income is not upon the business conducted, but it is also true that the income springs therefrom, and, following the situs thereof, as the child takes legally the residence of the parent, it carries the right of taxation with it." [105]

This says that a person is something more than a physical corpus. From the standpoint of legal relations, a person is the focus of many interests, and the person is *pro tanto* where any one of his interests is. It is with relations that the law has to deal, and the relations of a person may radiate to portions of the globe which his body never visits. Such a notion may be criticized as metaphysical, but it is not on that account an anomaly in the law. And, though metaphysical, it may well contain more of substantial realism than a view which sees in a person nothing but what is encased in a suit of clothes. Judge Stone does not rest with this justification for the assessment of income taxes on nonresidents. He uses it to meet Mr. Shaffer on his own ground, and then advances to another position. His analysis of the considerations that should control the legal concept of situs is well worth quoting:

[105] 250 Fed. 876–77 (1918).

"Such an income of a nonresident is taxable not only because it fits in with the theory of the right of all taxation, *i. e.*, protection, but for another reason. The situs of things and choses in action and legal rights rests in many cases upon a legal fiction. The necessity of avoiding confusion, inconvenience or injustice arises in some instance, and the law settles upon a so-called situs. Familiar illustrations are: A married woman ordinarily partakes of her husband's nationality and domicile; the law of domicile controls the descent of personalty; and many others to be found in the realm of private international law. These questions arise where there are conflicting claims of jurisdiction. Their settlement depends often, if not usually, upon broad considerations of public policy and justice. One main test in determining the public policy and justice of a situation is to examine the possible or probable effect of a particular holding. If the above view of this tax taken by the court does not prevail, there will result the possibility of avoidance of state income taxes. This latter through the possibility of taking up residence in a state with little or no taxation of that sort. Income taxation is too valuable and important a method of exercising the sovereign power of taxation to risk any diminution through a choice of residence at the hands of the party taxed who at the same time maintains his property and business as before. The public good requires its preservation in its entirety." [106]

There can be little doubt that one or the other or both of these views of Judge Stone will prevail to the extent of furnishing sufficient justification for state taxation of income from business within its borders, irrespective of the domicil or character of the ultimate recipient of that income.[107] It is most unlikely that any non-

[106] 250 Fed. 877 (1918).

[107] This prophecy is ventured, notwithstanding the dissent of Judge Campbell in Shaffer *v.* Howard. Judge Campbell relies on the following statement of Mr. Justice Field in State Tax on Foreign-Held Bonds, 15 Wall. (82 U. S.) 300, 319 (1872):

"The power of taxation, however vast in its character and searching in its extent, is necessarily limited to subjects within the jurisdiction of the State. These subjects are persons, property, and business. Whatever form taxation may assume, whether as duties, imposts, excises, or licenses, it must relate to one of these subjects. It is not possible to conceive of any other, though as applied to them, the taxation may be exercised in a great variety of ways."

On this as a premise, Judge Campbell insists that the Oklahoma income tax on residents is a tax on persons, and the tax on non-residents is either on persons, property or business. As a personal tax it cannot be sustained because there is no jurisdiction over the person of non-residents. As a tax on business or on property, it cannot be sustained because it selects for discrimination the property or the business of non-residents and thereby denies them the equal protection of the laws and the privileges and immunities of citizens of the several states.

resident will be given any deduction for the contribution of his intelligence to the creation of the income taxed. His intelligence is a factor only as it is applied, and it is applied where the business operations take place. Yet there still remains the inquiry whether extra-state operations should not, whenever feasible, be given weight in determining what portion of the result of bi-state activi-

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The weakness of the argument here is in the assertion that for the purpose of determining the validity of a tax on the property or business of nonresidents, "it must be considered as standing alone" (250 Fed. 873, 889). This is to say that it cannot be considered that residents are also taxed on their property and business within the state, when they are taxed on their income from that property and business and on other income besides. The argument is a flagrant example of the evil of reliance on differences in nomenclature to the disregard of similarity of substance.

Whether a state should tax nonresidents on other income than that from business within its borders is open to doubt. The economic values behind income from rentals, from interest on bonds and from dividends on stock are within the state and are taxable by the state through appropriate methods. As to land within the borders there has never been any question. As to bonds secured by property within the state, State Tax on Foreign-Held Bonds, *supra*, on which Judge Campbell relied, must be regarded as modified by Savings & Loan Society *v.* Multnomah County, note 109, *infra*, to the extent of permitting a state to declare that such bonds are an interest in the property by which they are secured and taxable as such an interest. So the stock of domestic corporations owned by nonresidents may be taxed. Corry *v.* Baltimore, 196 U. S. 466, 25 Sup. Ct. Rep. 297 (1905). On the other hand ordinary debts due from residents to nonresidents are not taxable except when there are special circumstances, as in Metropolitan Life Insurance Co. *v.* New Orleans, 205 U. S. 395, 27 Sup. Ct. Rep. 499 (1907), and cases therein cited.

In so far as a state tax on income is in lieu of actual or possible taxes on the sources of such income, there would seem to be no constitutional objection to a tax on income derived by nonresidents from such sources. When, however, such a tax on the income of nonresidents is in addition to taxes on the sources of such income, or is on income from non-taxable sources, a different question is presented. The Manitowoc Gas case, note 101, *supra*, shows the disinclination of the Wisconsin court to permit the taxation of income due nonresidents from bonds issued by a domestic corporation. The decision professes to be based on an interpretation of the statute, but the construction is strained, and the decision is plainly influenced by a notion that an interpretation permitting such taxation would make the statute unconstitutional. There can be little dispute that a state ought not to tax nonresidents on both the income and the sources of income or on income from non-taxable sources, with the possible exception of the case where the combined tax on the source and on the income is not greater than customary taxation on the source alone. Whether the considerations which should induce self-restraint on the part of the state are sufficiently compelling to warrant coercion on the part of the Supreme Court is more debatable, but in view of the fact that all income is likely to be held taxable to an owner at his domicil, there seems good reason to insist that other states from which such income is derived should be restrained from adding more than one additional tax. We cannot hope to avoid double taxation by the action of different states, but so far as practicable the line should be drawn at this point.

ties should be allocated to each of the two states. It does not seem wholly equitable that, when goods are manufactured in one state and sold in another, the state of origin should receive all the benefit and the state of destination none. Once it is recognized that net income from interstate commerce is a proper subject of state taxation, lawmakers should strive to devise some method of apportionment whereby income that is earned partly in one state and partly in another shall be fairly divided between the two.[108] Those who enjoy a market place other than the state of their domicil or of their manufacturing may reasonably be required to contribute to the governmental expenses of that market place, for some of those expenses are likely to redound to their benefit.

These considerations are doubtless more pertinent for legislators than for courts. Neither the Fourteenth Amendment nor the commerce clause prescribes a perfect system of taxation. No such system has thus far been evolved by the ingenuity of man. The courts can at best forbid only the most obvious inequities. Whatever rules of the apportionment of bi-state income may ultimately be sanctioned by the Supreme Court will operate in some particulars to the advantage of the state which suffers from their other effects. Each state is a state of origin of goods sold to its neighbors and a state of consumption of goods made by its neighbors. If Illinois is not allowed to get any of the proceeds of goods sold to her citizens from a factory in Wisconsin, she will be recompensed by not having to make deductions from the proceeds of goods sent from her factories to dwellers in Wisconsin. We can hardly look forward to an era when double taxation shall cease to be. The same hydra-headed conceptions which have permitted the economic value represented by intangibles to be reached by one state on one theory and by another state on another theory [109] will be likely to produce the same results in the taxation of income. The most we can aim for is the most satisfactory compromise and adjustment possible in a mundane world peopled and managed by finite individuals.

[108] The various types of unit rule will tend to make such an apportionment when the business in the several states is manufacture and sales and each state in which business is done is a market place for goods from other states and a place of origin for goods sent to other states.

[109] Compare Kirtland *v.* Hotchkiss, note 77, *supra*, with Savings & Loan Society *v.* Multnomah County, 169 U. S. 421, 18 Sup. Ct. Rep. 392 (1898).

An important step in this adjustment has been taken by a committee of the National Tax Association, of which Professor Bullock of Harvard University is chairman. This committee has drafted a plan of a model system of state and local taxation [110] which, if adopted by all the states, would go far towards remedying many of the evils now incident to the haphazard and contradictory tax systems of the sister states. The recommendations concern us here only in so far as they apply to income taxation. In brief the proposal is to divide income taxation sharply into a personal income tax and a business tax. In the taxation of personal incomes, the source of the income is to be neglected except when the federal Constitution forbids, as it probably still does in the case of income from the national government.[111] In addition to the personal income tax, there shall be a business tax on the net income derived from business carried on within the jurisdiction. Extra-state income will thus be taxed only to the ultimate human recipient at his domicil. Business income, as such, will be taxed only where the income is earned. The business tax is to be in lieu of the various other demands now made on corporations by way of excises, franchise taxes and the like. For special reasons some other method of fixing the amount of the business tax may be substituted for the reference to the net income.

These proposals, it is evident, will not do away with double taxation; but they will greatly minimize its inequities and other evils. There must continue to be two conceptions underlying an income tax: the earning of the income, and the enjoyment of the fruits thereof; the business, and the person. These two conceptions must be driven together in harness and under harmonious, if not unified, control. Only by securing the adoption of substantially similar plans by all the states to which the business of the nation penetrates can we avoid the complexities and diversities which now beset us. The Supreme Court can only fix the outside limits of decency. Within those limits there is need for all the intelligence that the states can muster to substitute a reasonable degree of

[110] Pamphlet issued by National Tax Association, 195 Broadway, New York City. The pamphlet will be contained in the PROCEEDINGS of the Association for 1918.

[111] In the next and concluding instalment of this series, consideration will be given to the inferences to be drawn from the opinion of Mr. Justice Pitney in the Oak Creek case, note 2, *supra*, as to the possibility of an abandonment of the doctrine that a state income tax cannot include the income from the federal government.

harmony for the chaos that is now characteristic of the aggregate of the fiscal systems of the several states.

III. *Taxes Not Measured by Income*

In his dissenting opinion in *Western Union Telegraph Co.* v. *Kansas*,[112] Mr. Justice Holmes remarked:

"If after this decision, the State of Kansas, without giving any reason, sees fit simply to prohibit the Western Union Telegraph Company from doing any more local business there or from doing local business until it has paid $20,100, I shall be curious to see upon what ground that legislation will be assailed." [113]

This curiosity cannot be said to have been completely satisfied by any of the decisions rendered thus far. In no case has a specific tax on local business been held to be a regulation of interstate commerce or a denial of due process of law. Yet, on the whole, the cases appear to negative the existence of an unlimited power to impose specific taxes on the local business of a concern that is also engaged in interstate commerce.

There are, indeed, intimations to the contrary in the decisions prior to the Western Union case. In *Postal Telegraph Cable Co.* v. *Charleston*,[114] which sustained a municipal tax of $500 on the local business of a telegraph company, Mr. Justice Shiras declared:

"If business done wholly within a State is within the taxing power of the State, the courts of the United States cannot review or correct the action of the State in the exercise of that power." [115]

In *Osborne* v. *Florida*,[116] which sanctioned a state statute imposing occupation taxes graded according to the number of inhabitants in the cities and towns in which the occupation was carried on, which statute the state court had construed as applicable only to local business, Mr. Justice Peckham observed:

"So long as the regulation as to the license or taxation does not refer to and is not imposed upon the business of the company which is interstate, there is no interference with that commerce by the state statute." [117]

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[112] 216 U. S. 1, 30 Sup. Ct. Rep. 190 (1910).
[113] *Ibid.*, 54–55.
[114] 153 U. S. 692, 14 Sup. Ct. Rep. 1094 (1894).
[115] *Ibid.*, 699–700.
[116] 164 U. S. 650, 17 Sup. Ct. Rep. 214 (1897).
[117] *Ibid.*, 655.

Pullman Co. v. *Adams* [118] and *Allen* v. *Pullman's Palace Car Co.*[119] have already been reviewed in the section dealing with taxes on privileges.[120] The judges here appeared to be of the opinion that no tax on the local business could be a burden on the interstate business so long as the company was free to abandon the local business. These two cases were strongly relied on by the dissent in the Western Union case. Mr. Justice Harlan distinguished them on the ground that they involved no device to reach interstate commerce or property beyond the state in the guise of a tax on local business,[121] thereby implying that such a device would henceforth receive the disapprobation of the court.

Two other cases prior to the Western Union case call for consideration. *Kehrer* v. *Stewart* [122] approved of a state statute "which provided that there should be assessed and collected 'upon all agents of packing houses doing business in this State, two hundred dollars in each county where said business is carried on.'" [123] The State court had construed the statute to be applicable only to local business. It was conceded that most of the business was interstate in character, though the exact proportion of each was not shown. In *Osborne* v. *Florida*,[124] ninety-five percent of the business was interstate. This fact is referred to by Mr. Justice Brown in the Kehrer case and declared to be immaterial. The attitude of the court on the general question is expressed as follows:

"If the amount of the domestic business were purely nominal, as, for instance, if the consignee of a shipment made in Chicago upon an order filled there, refused the goods shipped, and the only way of disposing of them was by sales at Atlanta, this might be held to be strictly incidental to an interstate business, and in reality a part of it, as we held in *Crutcher* v. *Kentucky*, 141 U. S. 47; but if the agent carried on a definite, though a minor, part of his business in the State by sales of meat there, he would not escape the payment of the tax, since the greater or less magnitude of the business cuts no figure in the imposition of the tax. There could be no doubt whatever that, if the agent carried on his interstate and domestic business in two distinct establishments, one would be subject

[118] 189 U. S. 420, 23 Sup. Ct. Rep. 494 (1903).
[119] 191 U. S. 171, 24 Sup. Ct. Rep. 39 (1903).
[120] 31 HARV. L. REV. 582–83. See also 32 HARV. L. REV. 405–06.
[121] 31 HARV. L. REV. 592–93.
[122] 197 U. S. 60, 25 Sup. Ct. Rep. 403 (1905).
[123] *Ibid.*, 61.
[124] Note 116, *supra*.

and the other would not be subject to the tax, and in our view it makes no difference that the two branches of the business are carried on in the same establishment. The burden of proof was clearly upon the plaintiff to show that the domestic business was a mere incident to the interstate business." [125]

Later, in dismissing objections urged under the equal-protection clause, Mr. Justice Brown declared:

"What the necessity is for such a tax, and upon what occupations it shall be imposed, as well as the amount of the imposition, are exclusively within the control of the State legislature. So long as there is no discrimination against citizens of other States, the amount and necessity of the tax are not open to criticism here." [126]

The Kehrer case was followed in *Armour Packing Co.* v. *Lacy*,[127] in which the tax was $100 in each county and the fact appeared that the company did a large local business.

These cases undoubtedly justify the curiosity betrayed by Mr. Justice Holmes in his Western Union dissent. The opportunity to satisfy that curiosity was presented to the Supreme Court in *Williams* v. *Talladega*,[128] but it was not grasped. A city ordinance imposing a tax of $100 was held void because it fell indiscriminately on all intra-state business including that done for the federal government. With respect to the contention material to our present purpose, Mr. Justice Day declared:

"It is further contended that the tax is unreasonable and unjust because of its effect upon interstate business. The reasonableness of the ordinance, unless some Federal right set up and claimed is violated, is a matter for the State to determine. It is contended that the result of the tax upon the intra-state business conducted at a loss is to impose a burden upon the other business of the company, and is therefore void. The Supreme Court of Alabama, however, reached the conclusion that the attempted test for eleven months, showing a loss of eighty-six cents, is not a sufficiently accurate representation of the business of the company conducted at Talladega to render the tax void. With this view we agree, and we are not satisfied that the tax is such as to impose a burden upon interstate commerce, and therefore make it subject to attack as a denial of Federal right." [129]

[125] 197 U. S. 60, 69, 25 Sup. Ct. Rep. 403 (1905).
[126] *Ibid.*, 70.
[127] 200 U. S. 226, 26 Sup. Ct. Rep. 232 (1906).
[128] 226 U. S. 404, 33 Sup. Ct. Rep. 116 (1912).
[129] *Ibid.*, 416–17.

Here is the possible implication that a tax on local business may be so large or so disproportionate to the business taxed as to be regarded as a device for reaching the interstate business. At any rate, the court had a chance to declare that the tax could not be a regulation of interstate commerce, whatever the facts might be as to the profitability of local business. By failing to do so, it invites other complainants to try again if they have a stronger case to support their claim. A similar invitation was extended in *Ohio Tax Cases*[130] considered in the preceding instalment of this discussion.[131]

The case which gives sufficient warrant for the belief that there is a limit to the power of the state to impose specific taxes on local business, when that business is united with an interstate business, is *General Railway Signal Co.* v. *Virginia*[132] decided in April a year ago. This case involved a writ of error from the Virginia decision considered in a previous section of this study.[133] The prophecy was there ventured that the Virginia decision would be reversed by the Supreme Court. This prophecy was founded on the assumption that the Virginia excise on foreign corporations was measured by total capital stock with no maximum limitation, since nothing to the contrary appeared in the opinion of the Virginia court. The assumption, however, was contrary to fact, as corporations having a capital of $90,000,000 or more paid only $5,000. Moreover, the amounts exacted of smaller corporations did not vary precisely with capital stock, except when the capital was between $50,000 and $1,000,000. One thousand dollars was demanded from every corporation with a capital between one and ten million dollars, $1,250 from those whose capital is between ten and twenty million, with corresponding increases of $250 for those in the higher classes. Thus the statute was like the hypothetical one suggested previously in this study,[134] in which, instead of a single maximum, there was a series of maxima graded roughly according to capital stock. In discussing such a statute, it was argued that if Massachusetts made its exaction proper by a $2,000 maximum which was of value only to corporations with a capital in excess of $10,000,000,

[130] 232 U. S. 576, 34 Sup. Ct. Rep. 372 (1914).

[131] 32 HARV. L. REV. 405–07.

[132] 246 U. S. 500, 38 Sup. Ct. Rep. 360 (1918).

[133] General Railway Signal Co. *v.* Commonwealth, 118 Va. 301, 87 S. E. 598 (1916), 31 HARV. L. REV. 756–60.

it would not transgress by adding lower maxima for smaller corporations.[135] A statute with a maximum, it was urged, should be regarded as one imposing a specific tax, with a sliding discount in favor of corporations whose moderate capitalization entitled them to it.[136]

This is in substance the Virginia statute. It imposes a specific $5,000 fee and allows corporations having less than $90,000,000 a deduction measured not precisely, but roughly, according to the amount by which their capital is less than $90,000,000. Mr. Justice McReynolds appears to conceive it important that Virginia put the corporations into ten-million-dollar groups and did not vary the tax directly according to the capital, but it is hard to see how this is significant where there are fixed maxima. Moreover this does not describe the method of measuring the tax on corporations whose capital was between $50,000 and $1,000,000. The statute could hardly have been more palatable if all such corporations were charged the same amount, instead of a percentage of their actual capital. What is important is that there shall be a fair limit to any tax that may be imposed. It is apparent that the maximum or maxima must be reasonable, or the situation comes within the Western Union case rather than the Baltic Mining case.

Such is clearly the position taken by the court in *General Railway Signal Co.* v. *Virginia*.[137] The approval of the Virginia decision was accorded gingerly, Mr. Justice McReynolds saying:

"Inspection of the statute shows that prescribed fees do not vary in direct proportion to capital stock, and that a maximum is fixed. In the class to which plaintiff in error belongs the amount specified is one thousand dollars and, under all the circumstances, we cannot say that this is wholly arbitrary or unreasonable.

"Considering what we said in *Baltic Mining Co.* v. *Massachusetts*, 231 U. S. 68; *St. Louis Southwestern Ry. Co.* v. *Arkansas*, 235 U. S. 350; *Kansas City, Ft. Scott & Memphis Ry. Co.* v. *Botkin*, 240 U. S. 227; *Kansas City, Memphis & Birmingham R. R. Co.* v. *Stiles*, 242 U. S. 111, the two characteristics of the statute just referred to must be regarded as sufficient to save its validity. It seems proper, however, to add that the case is on the border line. See *Looney* v. *Crane Co.*, 245 U. S. 178;

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[134] 31 HARV. L. REV. 738–39.

[135] *Ibid.*

[136] 31 HARV. L. REV. 777, 941–42.

[137] Note 132, *supra*.

International Paper Co. v. *Massachusetts*, 246 U. S. 135, and *Locomobile Co.* v. *Massachusetts*, 246 U. S. 146." [138]

Among the circumstances thus taken into consideration and previously detailed in the opinion was the fact that the company's contracts in Virginia called for a total consideration in excess of $200,000. The caution that the case is on the border line and the mild approval of the tax as not wholly arbitrary or unreasonable show clearly that a maximum limit or series of limits to an excise measured or roughly graded in accordance with capital stock does not save the statute from sin unless the maximum is reasonable. Curiosity may still be piqued to discover what will be the test or tests of reasonableness, but we may now be satisfied that a flat charge on the local business of a company that also conducts interstate business is not immune from condemnation as a regulation of interstate commerce and a denial of due process of law. If this is true of an excise on the local business of a foreign corporation, it must also be true of specific taxes on acts or occupations, where we are relieved from any intrusion of the notion of an arbitrary power over the doings of a corporate entity.

There remains for consideration only the question of the proper test of reasonableness. *St. Louis, Southwestern R. Co.* v. *Arkansas* [139] declares that the basis of an excise on a foreign corporation engaged in combined local and interstate commerce may be that proportion of the total capital stock which represents the value of the property within the taxing district, though such property is used in interstate as well as local commerce. This excise measured by the property within the state was in addition to an ordinary property tax, but it appeared that the right to do business as a corporation was not included in the assessment of that ordinary property tax. Mr. Justice Pitney's opinion is flavored with the notion that this excise and the so-called ordinary property tax together did no more than to assess the total property at its value as a going concern, but it is not definitely stated that the propriety of measuring an excise on local business by the total property in the state is conditioned on the mode by which that property is assessed for ordinary taxation. It seems reasonable to assume that, in the

[138] 246 U. S. 500, 511, 38 Sup. Ct. Rep. 360 (1918).
[139] 235 U. S. 350, 35 Sup. Ct. Rep. 99 (1914).

absence of special circumstances, an excise or occupation tax on a local business may be based on all the property used in that business even though that property is also used in interstate business and is also subjected to an *ad valorem* property tax.[140] But it may readily be conceived that special circumstances may make such a measure of an excise or occupation tax a very real burden on interstate commerce. It is apparent that when such taxes are imposed on specially selected enterprises, they may in fact constitute serious discriminations against interstate commerce. All the property may be used for local as well as interstate commerce and yet the latter constitute by far the greater part of the total business. If a state is allowed free range in prescribing the rate of levy on such a property base, it may do quite as serious an injury to interstate commerce as it could inflict by basing the tax on total capital stock. Though the court may as a general rule accept property employed in local business as the proper measure of an occupation tax on that business, it must always have at hand its doctrine that every case depends on its own circumstances and must be ready to find the special circumstances that take the case out of the general rule.

It must be impossible to lay down any general rule as to what is a proper amount to impose as a specific tax on a local business that is combined with an interstate business. All that can be said is that by and large the punishment must fit the crime. One thousand dollars may not have been too much for Virginia to demand of the Railway Signal Company in view of its contracts within the state. Yet the same sum based on the same capital stock might prevent it from bidding on small contracts within the state. Where the performance of the contract calls for interstate as well as local enterprise, a fee out of all proportion to the consideration for the contract may stand as an absolute bar to the particular interstate commerce. This is the vice of all occupation or business taxes that are not measured by the value of what is being taxed. The vice is particularly noxious in the case of corporations not regularly engaged in business within the state, but which merely enter to do occasional jobs. The vice does not seem to have manifested itself

[140] In Amos *v.* Postal Telegraph-Cable Co. (Fla.), 80 So. 293 (1918), the supreme court of Florida held that a state license fee or occupational tax measured by property within the state should exclude from the computation property employed exclusively in interstate commerce. The opinion regarded the construction as necessary to save the tax from being an unconstitutional regulation of interstate commerce.

in any of the cases of specific taxes that have come before the court, including the excises of Massachusetts and Virginia on foreign corporations. But there is no telling what concerns have been prevented by those taxes from coming in to take small, isolated contracts. Now that the states are assured that they may tax the income from all business done within the state, whether that business is local commerce or interstate commerce, there is no further excuse for any form of specific taxes for a general fiscal purpose.

Through an income tax, the state may tax interstate as well as local commerce. This bears on the question of the reasonableness of specific taxes so long as the states choose to continue them. All that is subject to such a tax in strict legal theory is the local business. But we should not infer from this that the tax becomes an invalid regulation of interstate commerce as soon as it is disproportionate to the local business. The interstate commerce is taxable, if the state goes about it in the right way. It may reach it by valuing property by a capitalization of earnings from its use, by imposing a gross-receipts tax in lieu of other taxes, and by levying a tax on net incomes. So also it should be allowed to reach it by specific taxes on local business, provided those taxes are not otherwise improper. The test of the reasonableness of any form of specific tax should be the relation of the amount demanded, not to the legal *res* which is formally the subject of taxation, but to the economic interest which in the light of all the decisions is actually liable for its proportional contribution to the state fisc.

(To be concluded.)

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